HALF-YEARLY REPORT 2014

BAE SYSTEMS

INSPIRED WORK

BAE SYSTEMS PLC
HALF-YEARLY REPORT 2014

RESULTS IN BRIEF

	Six months ended 30 June 2014	Six months ended 30 June 2013[1]	Year ended 31 December 2013
Sales[2]	**£7,611m**	£8,487m	£18,180m
Underlying EBITA[3]	**£802m**	£867m	£1,925m
Operating profit	**£689m**	£752m	£806m
Underlying earnings[4] per share	**17.7p**	17.9p	42.0p
Basic earnings per share[5]	**13.5p**	12.7p	5.2p
Order backlog[2,6]	**£39.7bn**	£43.2bn	£42.7bn
Dividend per share	**8.2p**	8.0p	20.1p
Operating business cash flow[7]	**£287m**	£(815)m	£147m
Net Debt (as defined by the Group)[8]	**£(1,182)m**	£(1,192)m	£(699)m

Ian King, Chief Executive, said *"Operationally, the Group continues to perform well, benefiting from good programme performance on its large order backlog of almost £40bn. We continue to see a high level of activity in international markets, including from our substantial presence in the Kingdom of Saudi Arabia, while the US and UK environments remain more constrained. Sales are anticipated to be weighted towards the second half of 2014, including the timing of Typhoon aircraft deliveries. We are finalising a further £1.3bn of international orders and are at an advanced stage of negotiations on a further £1bn of UK sole source naval contracts. Excluding the impact of exchange translation, the Group remains on track to deliver earnings in line with our expectations for the full year."*

FINANCIAL KEY POINTS

– The second half bias on Typhoon aircraft deliveries together with the expected lower volumes at Land & Armaments contributed to a 10% decrease in sales[2] (6% at constant currency)

– Good margin performance in most businesses, whilst reduced volumes decreased underlying EBITA[3] by 7% (4% at constant currency)

– The benefits of the share repurchase programme and lower tax rate largely offset the lower underlying EBITA[3] resulting in underlying earnings[4] per share of 17.7p

– Large order backlog[2,6] of £39.7bn after exchange translation of £0.4bn

– Interim dividend increased by 2% to 8.2p per share

– £618m returned to shareholders in the period, including £235m on the share repurchase programme

1 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.
2 Including share of equity accounted investments.
3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
4 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 4).
5 Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.
6 Order backlog comprises funded and unfunded unexecuted customer orders, and is stated after the elimination of intra-group orders.
7 Net cash inflow/(outflow) from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.
8 See definition on page 9.

OPERATIONAL AND STRATEGIC HIGHLIGHTS

– Major milestone achieved with float-up of aircraft carrier, HMS Queen Elizabeth

– UK government commitment to further Typhoon aircraft capability development

– Progress in future combat air technologies:

  – Successful flight trials of Taranis unmanned combat air vehicle

  – UK/French government commitment to develop joint Future Combat Air System technology

– Reorganisation of industrial partner companies in the Kingdom of Saudi Arabia to support their future growth

– Proposed bolt-on acquisition of US intelligence capability, Signal Innovations Group, Inc., to augment imagery and data analysis technologies

– Selected to provide integrated flight control electronics for next-generation Boeing 777X

– Applied Intelligence order backlog up by a further 25%, following 60% increase in 2013

– Further streamlining of US business

OUTLOOK

Group

With the non-recurring benefit from the Salam price escalation settlement in the second half of 2013, and before exchange translation, the Group continues to expect reported earnings[4] per share to be some 5% to 10% lower than in 2013. Exchange translation, assuming an average US$1.70 exchange rate, is expected to impact those earnings by around one pence compared to previous guidance.

Reporting segments

Electronic Systems: Sales[2], in US dollars, in 2014 are expected to be similar to those in 2013 with margins at the high end of a 12% to 14% range.

Cyber & Intelligence: Sales[2], in US dollars, in 2014 are expected to be some 5% lower than those in 2013 with margins towards the higher end of an improved 8% to 10% range.

Platforms & Services (US): In 2014, sales[2] in the Land & Armaments business (adjusted for the transfer out of the UK Munitions business into Platforms & Services (UK)) are expected to be in the $2.25bn to $2.4bn range with margins slightly ahead of the previous 9% guidance. Sales[2] in the Support Solutions business are expected to be a little lower than in 2013 and, due to the further charges taken in the first half on commercial shipbuilding, margin guidance is reduced.

Platforms & Services (UK): As a result of the trading in 2013 of the price escalation on the Salam Typhoon contract, and excluding the transfer in of the UK Munitions business, sales[2] are expected to reduce by around 5% with margins expected to return to a 10% to 12% range.

Platforms & Services (International): Sales[2] are expected to be similar to 2013, other than for exchange translation, with margins in a 10% to 12% range.

2 Including share of equity accounted investments.
4 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 4).

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Analyst and investor presentation

A live webcast for analysts and investors will be held today (31 July 2014) at 10.00am. Details can be found on **www.baesystems.com/investors**, together with presentation slides and a pdf copy of this report. A recording of the webcast will be available later in the day.

About BAE Systems

BAE Systems serves the needs of its customers by delivering a wide range of advanced defence, aerospace and security solutions that provide a performance edge. With some 83,400 employees in six continents, we work together with local partners to develop, engineer, manufacture and support the innovations that increase defence sovereignty, sustain economies and safeguard commercial interests.

INTERIM MANAGEMENT REPORT

Operationally, the Group continues to perform well, benefiting from good programme performance on its large order backlog of almost £40bn. We continue to see a high level of activity in international markets, including from our substantial presence in the Kingdom of Saudi Arabia, while the US and UK environments remain more constrained. Sales are anticipated to be weighted towards the second half of 2014, including the timing of Typhoon aircraft deliveries. We are finalising a further £1.3bn of international orders and are at an advanced stage of negotiations on a further £1bn of UK sole source naval contracts. Excluding the impact of exchange translation, the Group remains on track to deliver earnings in line with our expectations for the full year.

US

As anticipated, the impact of budget reduction actions continues to constrain activity across the Group's US business, but the bipartisan budget approval, in December 2013, is providing improved near-term clarity.

In this environment, BAE Systems has seen an improving level of procurement activity in Electronic Systems and Platforms & Services (US). Activity in the Intelligence & Security domain continues to be impacted by reduced analyst support activity in line with US troop withdrawals from Afghanistan. Last year's performance issues on the Radford ammunition facility management contract and in commercial shipbuilding continued to depress margins in the US Support Solutions business into 2014.

Recognising the continued challenges in the US market, a restructuring has been announced that has streamlined the US organisation to three operating sectors and reduced administrative overhead across the sectors and in the headquarters.

The Group continues to grow in commercial aircraft electronics, including accessing additional aircraft platform positions. In July, Boeing selected BAE Systems as its supplier of advanced, integrated flight control electronics on its next-generation 777X programme. The business also provides digital engine controls for GE commercial aircraft engines and is developing them for GE's next-generation LEAP and Passport engines that will power the Boeing 737 MAX, Airbus A320neo, Comac C919 and Bombardier Global 7000/8000 aircraft.

In July, BAE Systems agreed to the proposed acquisition of Signal Innovations Group, Inc., a provider of imaging technologies and analytics to the US intelligence community. The proposed acquisition is conditional upon receiving certain regulatory approvals. It is anticipated that the proposed acquisition will be completed during the third quarter of 2014.

UK

The UK environment remains stable following the actions to address programme priorities identified by the Strategic Defence and Security Review in 2010 and the subsequent rebalancing of budgets.

Activity across the military air domain continues to benefit from Typhoon production and the Group's extensive in-service military aircraft support and upgrade business. Twelve Typhoon aircraft were delivered by the Eurofighter partners to European and Saudi air forces in the first half of 2014. Aircraft deliveries are expected to have a second half bias, with a total of 30 aircraft planned to be delivered to the European and Saudi customers by the Eurofighter partners in the second half of the year. A significant increase in activity is underway to clear additional weapons and sensor capabilities onto the aircraft for the four partner nations and international customers.

The Group's participation in the F-35 combat aircraft programme continues to develop. Twenty-one F-35 aft fuselage assemblies were delivered in the period. Significant growth is anticipated as the planned aircraft delivery rate starts to accelerate.

The outlook for the Group's UK maritime businesses is robust. The build of two Queen Elizabeth class aircraft carriers is progressing well. The first of class was named in a formal ceremony by Her Majesty The Queen on 4 July and has now been floated successfully out of the dock in which she was assembled to continue outfitting. The block build of the second vessel is some 70% complete.

Actions continue to implement and finalise contracts for the restructuring of the Group's naval business following last year's agreement with the UK government. As part of the assessment phase of the Type 26 frigate programme, BAE Systems has made a proposal for the future phases of the programme. Anticipated progress on Type 26 ships, together with the commitment to build three Offshore Patrol Vessels and the UK naval shipbuilding restructuring agreement, will provide long-term clarity for complex warship manufacture.

Discussions are underway to extend the Spearfish torpedo contract into demonstration and full manufacture, and negotiations are at an advanced stage on the multi-year Maritime Support Delivery Framework contract.

In the submarines business, Artful, the third of seven Astute class submarines, was launched in May. Alongside build of Astute class boats, engineering work continues to accelerate on the Successor programme, the potential replacement for the Vanguard class fleet, intended to enter service towards the end of the next decade.

In September, Scotland will hold an independence referendum. The decision on independence from the UK is a matter for the people of Scotland. However, as stated previously, BAE Systems has significant interests and employees in Scotland, and it is clear that continued union offers greater certainty and stability for our business.

BAE Systems continues to develop successfully its strategy for commercial cyber, with growth being demonstrated and a number of recent important contract wins in the first six months of the year. Order backlog in Applied Intelligence has grown by 25% since 31 December 2013.

International

In Saudi Arabia, the Group is progressing the provision of capabilities, including delivery of a further four Typhoon aircraft in the period and the development of the Group's position as a key part of the Kingdom's defence industrial base. Work continues to expand the capability on the aircraft, including finalising additional orders of £1.3bn. In February, discussions on price escalation on the Salam Typhoon programme reached agreement with the Saudi Arabian government.

In June, BAE Systems announced a reorganisation of its portfolio of interests in a number of industrial companies in Saudi Arabia and an enhancement of its existing relationship with Riyadh Wings Aviation Academy LLC (Riyadh Wings). The reorganisation is expected to enhance the growth prospects of this portfolio of businesses and reinforce an ongoing commitment to support the national agenda of developing an indigenous defence industry, supporting skills and technology development, and increasing local employment.

Through a number of transactions, the reorganisation will bring together shareholdings of BAE Systems and Riyadh Wings in Saudi companies specialising in training, electronics and IT systems engineering under a single holding company. Riyadh Wings will acquire a 49% stake progressively in the holding company with BAE Systems continuing to hold a majority stake. Completion of the transactions to effect the reorganisation is conditional on the satisfaction of certain regulatory approvals.

In Australia, where BAE Systems is the largest defence contractor, the government commitment to grow defence spending to 2% of Gross Domestic Product is encouraging following a period of reductions.

The Canberra class Landing Helicopter Dock (LHD) programme for the Royal Australian Navy is progressing well, with the first of the two ships expected to be delivered to the customer in the second half of the year following sea trials. The Group continues to discuss with the Australian government options to sustain industrial capabilities and meet potentially substantial future naval requirements following on from the LHD programme.

Across the wider international marketplace, the MBDA guided weapons joint venture has seen increased bidding interest in some regions in response to changing threats and defence priorities. In July, MBDA received a £250m contract to supply the Advanced Short Range Air-to-Air Missile (ASRAAM) for India's Jaguar aircraft fleet.

Balance sheet and capital allocation

The Group's balance sheet continues to be managed conservatively in line with the Group's policy to retain its investment grade credit rating and to ensure operating flexibility. Consistent with this approach, the Group expects to continue to meet its pension obligations, pursue organic investment opportunities, plans to pay dividends in line with its policy of long-term sustainable cover of around two times underlying earnings and to make accelerated returns of capital to shareholders when the balance sheet allows. Investment in value-enhancing acquisitions will be considered where market conditions are right and where they deliver on the Group's strategy.

Triennial funding valuations of all of the Group's UK pension schemes commenced in April and discussions with the trustees regarding the underpinning assumptions in determining those valuations are in progress.

In February 2013, the Group initiated a share repurchase programme of up to £1bn over three years. As at 30 June 2014, BAE Systems had purchased 108.2 million shares for £447m under the programme. In the first half of 2014, 56.6 million shares were bought for £235m.

Directors

On 1 February 2014, Sir Roger Carr succeeded Sir Richard Olver as Chairman of the Board of BAE Systems plc and Sir Richard stepped down from the Board on that date.

Also on 1 February 2014, Linda Hudson retired as President and Chief Executive Officer of BAE Systems, Inc. and as an executive director of BAE Systems plc. On the same date, Jerry DeMuro was appointed as President and Chief Executive Officer of BAE Systems, Inc. and as an executive director of BAE Systems plc.

Paul Anderson, a non-executive director, will retire from the Board on 31 December 2014. Consequently, Ian Tyler has succeeded him recently as chairman of the Board's Corporate Responsibility Committee.

Dividend

The Board has declared a 2% increase in the interim dividend to 8.2p for the first half year to 30 June 2014. At this level, the dividend is covered 2.2 times by underlying earnings and remains consistent with the Group's policy of long-term sustainable cover of around two times.

Summarised income statement

	Six months ended 30 June 2014 £m	Six months ended 30 June 2013[1] £m
Sales[2]	**7,611**	8,487
Underlying EBITA[3]	**802**	867
Profit on disposal of businesses	**–**	4
EBITA	**802**	871
Amortisation of intangible assets	**(88)**	(96)
Impairment of intangible assets	**–**	(4)
Finance costs[2]	**(169)**	(223)
Taxation expense[2]	**(111)**	(133)
Profit for the period	**434**	415

Underlying earnings[4] per share	**17.7p**	17.9p
Basic earnings per share[5]	**13.5p**	12.7p
Dividend per share	**8.2p**	8.0p

Exchange rates – average	Six months ended 30 June 2014	Six months ended 30 June 2013
£/$	**1.669**	1.544
£/€	**1.218**	1.175
£/A$	**1.825**	1.524

Exchange rates – period end	30 June 2014	30 June 2013
£/$	**1.711**	1.517
£/€	**1.249**	1.167
£/A$	**1.812**	1.657

Exchange rates – year end	31 December 2013
£/$	1.656
£/€	1.202
£/A$	1.851

Segmental analysis

	Sales[2]		Underlying EBITA[3]	
	Six months ended 30 June 2014 £m	Six months ended 30 June 2013[1] £m	Six months ended 30 June 2014 £m	Six months ended 30 June 2013[1] £m
Electronic Systems	**1,108**	1,194	**143**	156
Cyber & Intelligence	**529**	657	**47**	53
Platforms & Services (US)	**1,662**	2,085	**105**	182
Platforms & Services (UK)	**2,844**	3,231	**393**	386
Platforms & Services (International)	**1,576**	1,654	**157**	165
HQ*	**127**	145	**(43)**	(75)
Intra-group	**(235)**	(479)	**–**	–
	7,611	8,487	**802**	867

* In 2014, the HQ reporting segment includes, in underlying EBITA, a £30m benefit (2013 £nil) from re-assessment of a long-term liability and a £17m charge (2013 £32m) in respect of a US contract pricing dispute.

Income statement

Sales[2] in the first half reduced by some £0.9bn to £7,611m, with £0.4bn of that reduction due to exchange translation. The volume reductions in Land & Armaments were as expected and there is significant second half bias in sales due to the contracted delivery schedules for Typhoon aircraft this year.

Underlying EBITA[3] was £802m (2013 £867m) after adverse exchange translation of £33m, giving an increased return on sales of 10.5% relative to 2013 (10.2%). Lower margins in Support Solutions have been offset by accelerated risk reduction at Land & Armaments and Platforms & Services (UK).

Amortisation of intangible assets was £88m (2013 £96m).

Finance costs[2] were £169m (2013 £223m). The underlying interest charge, excluding pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements, was £89m (2013 £95m). Net interest expense on the Group's pension deficit was lower at £76m (2013 £98m) mainly reflecting the reduction in the deficit during 2013.

Taxation expense[2] reflects the Group's effective tax rate for the period of 20.4% (2013 24.5%). The effective tax rate for the full year is also expected to be around 20%, with the final number dependent on the geographical mix of profits.

Underlying earnings[4] **per share** for the period was 17.7p (2013 17.9p) benefiting from the Group's share repurchase programme and lower tax rate.

Basic earnings per share[5] for the period was 13.5p (2013 12.7p).

1 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.
2 Including share of equity accounted investments.
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4 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (see note 4).
5 Basic earnings per share in accordance with International Accounting Standard 33, Earnings per Share.

Reconciliation of cash flow from operating activities to Net Debt (as defined by the Group)

	Six months ended 30 June 2014 £m	Six months ended 30 June 2013 £m
Cash outflow from operating activities	**(30)**	(728)
Capital proceeds/(expenditure) (net) and financial investment	**304**	(97)
Dividends received from equity accounted investments	**13**	10
Operating business cash flow	**287**	(815)
Interest	**(76)**	(81)
Taxation	**(65)**	(94)
Free cash flow	**146**	(990)
Acquisitions and disposals	**–**	6
Share repurchase programme	**(235)**	(90)
Other purchase of own shares	**(2)**	–
Equity dividends paid	**(383)**	(380)
Dividends paid to non-controlling interests	**(2)**	(12)
Cash flow from matured derivative financial instruments	**(57)**	33
Movement in cash collateral	**(7)**	2
Foreign exchange translation	**63**	(170)
Other non-cash movements	**(6)**	22
Total cash outflow	**(483)**	(1,579)
Opening Net (Debt)/Cash (as defined by the Group)	**(699)**	387
Closing Net Debt (as defined by the Group)	**(1,182)**	(1,192)
Comprising:		
Debt-related derivative financial assets	**3**	38
Cash and cash equivalents	**1,374**	1,919
Loans – non-current	**(2,459)**	(2,809)
Loans and overdrafts – current	**(100)**	(338)
Less: Cash received on customers' account[6]	**–**	(2)
Net Debt (as defined by the Group)	**(1,182)**	(1,192)

Operating business cash flow

	Six months ended 30 June 2014 £m	Six months ended 30 June 2013[1] £m
Electronic Systems	**86**	73
Cyber & Intelligence	**24**	56
Platforms & Services (US)	**109**	(89)
Platforms & Services (UK)	**(201)**	(411)
Platforms & Services (International)	**541**	(221)
HQ	**(272)**	(223)
Operating business cash flow	**287**	(815)

Cash flows

Cash outflow from operating activities was £30m (2013 £728m), which includes contributions in excess of service costs for the UK and US pension schemes totalling £163m (2013 £192m).

As anticipated, advances continue to be consumed on the Omani Typhoon and Hawk programme, the European Typhoon contract and the Saudi training aircraft contract. The first of two payments under the Salam Variation of Price settlement has been received. Costs incurred are being charged against a number of provisions created in previous years.

The net cash proceeds from **capital expenditure and financial investment** of £304m (2013 £97m outflow) includes the sale and leaseback of two properties in Saudi Arabia, of which £418m was received in the period following the receipt of deposits totalling £23m in 2013.

Dividends received from equity accounted investments, mainly comprising Eurofighter and FNSS, amounted to £13m (2013 £10m).

The cash outflow in respect of the **share repurchase programme** of £235m (2013 £90m) represents shares purchased and cancelled under the programme announced in February 2013.

Foreign exchange translation during the period, primarily in respect of the Group's US dollar-denominated borrowing, reduced reported Net Debt by £63m.

Net Debt (as defined by the Group)

The Group's Net Debt at 30 June 2014 was £1,182m (30 June 2013 £1,192m), a net outflow of £483m from the Net Debt position of £699m at the start of the period.

A $500m, 4.95% bond was repaid at maturity in June. This repayment, together with a £100m, 10¾% bond due to be repaid in the second half of 2014, was largely pre-financed by the £0.4bn raised in the UK bond market in 2012.

Cash and cash equivalents of £1.4bn (30 June 2013 £1.9bn) are held primarily for the share repurchase programme, pension deficit funding, payment of the 2014 interim dividend, repayment of £0.1bn of debt securities maturing in the second half of 2014 and management of working capital.

Going concern

After making due enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future and therefore continue to adopt the going concern basis in preparing the accounts.

Principal risks

The principal risks facing the Group for the remainder of the year are unchanged from those reported in the Annual Report 2013.

These risks, together with the Group's risk management process, are detailed on pages 106 to 111 of the Annual Report 2013, and relate to the following areas: defence spending; government customers; global market; contract award timing; large contracts; fixed-price contracts; component availability, subcontractor performance and key suppliers; laws and regulations; competition; pension funding; export controls and other restrictions; acquisitions; consortia and joint ventures; exchange rates; and cyber security.

1 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.
6 Cash received on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance. It is included within trade and other payables in the consolidated balance sheet.

REPORTING SEGMENTS: ELECTRONIC SYSTEMS

Electronic Systems, with 12,500 employees[1], comprises the US and UK-based electronics activities, including electronic warfare systems and electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

	Six months ended 30 June 2014	Six months ended 30 June 2013	Year ended 31 December 2013
Sales[1]	**£1,108m**	£1,194m	£2,466m
Underlying EBITA[2]	**£143m**	£156m	£346m
Return on sales	**12.9%**	13.1%	14.0%
Cash inflow[3]	**£86m**	£73m	£235m
Funded order intake[1]	**£1,160m**	£1,124m	£2,697m
Order backlog[1,4]	**£3.6bn**	£3.7bn	£3.7bn

Financial performance

The business delivered sales[1] of $1.85bn (£1.1bn), in line with both last year and guidance. Sales[1] in the commercial areas of the business now stand at 22% and growth there is helping to offset the expected pressures on the defence side.

The return on sales achieved of 12.9% was consistent with the first half of 2013.

Cash[3] conversion of underlying EBITA[2] in the first half year was at 60% and an improved conversion level is expected over the full year.

Despite the US budget pressures, order backlog[1,4] of $6.2bn (£3.6bn) has been sustained since the start of the year on further F-35 Low-Rate Initial Production awards.

Operational performance

Electronic Combat

Electronic Systems maintains its leadership position in the US electronic warfare market. Initial design verification testing of the electronic warfare suite on the F-35 Lightning II programme was completed during the period. Low-Rate Initial Production (LRIP) Lots 6 and 7 deliveries continued and the business was awarded a $143m (£84m) contract for LRIP Lot 8.

Under contracts totalling over $0.9bn (£0.5bn) to install the Digital Electronic Warfare System on 84 new F-15 aircraft and upgrade 70 existing F-15 aircraft for the Royal Saudi Air Force, system qualification and flight testing continues towards initial fielding scheduled for early 2015.

Following successful US Defense Advanced Research Projects Agency programme flight demonstrations, Electronic Systems is now under contract to design, develop and deliver the electronic sensors for the Long-Range Anti-Ship Missile in support of its rapid fielding on board F/A-18 and B-1B aircraft in response to an urgent operational need.

Survivability & Targeting

The business completed its $38m (£22m) Common Infrared Countermeasures technology development contract on a US Army helicopter programme and proposals for the Engineering and Manufacturing Development phase will be submitted in the second half of the year, with an award decision expected in the first half of 2015.

A $496m (£290m), three-year Indefinite Delivery, Indefinite Quantity (IDIQ) contract with the US Army was agreed in May for third-generation Common Missile Warning Systems (CMWS). Additional CMWS orders totalling $33m (£19m) were placed by the UK Ministry of Defence and other US customers.

Whilst the business continues to execute its $82m (£48m) Advanced Precision Kill Weapon System full-rate production contract with the US Navy, Jordan and the US Navy signed a Letter of Offer and Acceptance in May to progress the first international sale of the laser-guided rocket system.

The business continues to perform on Terminal High-Altitude Area Defence orders for 307 infrared missile seekers supporting both the US government and Foreign Military Sales worth $340m (£199m).

Electronic Systems was awarded a five-year IDIQ contract with a potential value of approximately $445m (£260m) to support the US Army's Enhanced Night Vision Goggle III and Family of Weapon Sights – Individual programme. However, this award is under protest pending a decision from the US Government Accountability Office (GAO) and, depending on the GAO ruling, the US Army.

Communications & Control

The business continues to pursue international market opportunities, focusing on the Middle East and Asia, with product offerings including flight controls, displays, and communications and datalink systems.

Intelligence, Surveillance & Reconnaissance

The business provides airborne surveillance capability for the US Army and US Air Force with the Airborne Wide Area Persistent Surveillance System and Autonomous Real-time Ground Ubiquitous Surveillance – Imaging System, as well as state-of-the-art mission computers and displays to Boeing for the US Navy's P-8A Poseidon programme.

The business continues to provide Signals Intelligence capability for the US Army and Special Operations Command. In June, BAE Systems was awarded a two-year IDIQ contract worth up to $70m (£41m) to provide Tactical Signals Intelligence Payloads and associated equipment for the US Army's Gray Eagle unmanned aircraft.

In the Identification Friend or Foe market, BAE Systems was awarded an IDIQ contract in April for 16 digital interrogators and 45 field change kits for the US Navy and the government of Japan through a Foreign Military Sales agreement.

Commercial Aircraft electronics

BAE Systems is a major supplier to Boeing for flight controls, and cabin and deck systems. The business has been selected to provide the fly-by-wire spoiler controls, flap/slat electronic unit and flight-deck electronics on the 737 MAX aircraft. In July, Boeing selected BAE Systems as its supplier of advanced, integrated flight control electronics on its next-generation 777X programme. The business also provides digital engine controls for GE commercial aircraft engines and is developing them for GE's next-generation LEAP and Passport engines that will power the Boeing 737 MAX, Airbus A320neo, Comac C919 and Bombardier Global 7000/8000 aircraft.

The business continues to expand its aftermarket opportunities for Full Authority Digital Engine Controls. A long-term agreement has been signed with Southwest Airlines to provide maintenance, repair and overhaul services from its worldwide service centre network.

Several airlines and original equipment manufacturers have expressed interest in the Group's IntelliCabin™ product that provides in-seat power, LED lighting and tablet-based wireless in-flight entertainment systems. Development activities remain on track for initial availability in early 2015.

Both Embraer's Legacy mid-size business jet and Bombardier's CSeries regional aircraft are engaged in flight testing enabled by several flight control subsystems provided by BAE Systems.

HybriDrive® propulsion systems

As part of the Iveco team, BAE Systems was chosen to provide up to 600 HybriDrive® Series-E systems for hybrid city buses in Paris, France. The business has begun deliveries of 475 HybriDrive® propulsion systems for Nova Bus hybrids in Quebec, Canada.

Looking forward

Efforts to reduce the US government's budget deficit are expected to continue to impact government spend. A bipartisan budget proposal was approved in December 2013 that mitigates the full impact of the Sequester for 2014 and 2015. The Group expects lower defence spending than previously programmed, but the cuts are not expected to be as significant or indiscriminate as they would have been under Sequestration.

Whilst further funding reductions and the resultant slow down or cancellation of ongoing and new programmes could impact the business, Electronic Systems continues to be well-positioned to address the changing US Department of Defense priorities with its balanced portfolio of programmes and customers, and its sustained emphasis on cost reduction and research and development.

The business expects to benefit from its incumbent positions, particularly on the F-35 Lightning II programme, and ability to provide capability upgrades on platforms. The business anticipates increased activity on international defence programmes and continued growth in the commercial aviation market.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.
4 Order backlog comprises funded and unfunded unexecuted customer orders.

REPORTING SEGMENTS: CYBER & INTELLIGENCE

Cyber & Intelligence, with 7,500 employees[1], comprises the US-based Intelligence & Security business and UK-headquartered Applied Intelligence business, and covers the Group's cyber, secure government, and commercial and financial security activities.

	Six months ended 30 June 2014	Six months ended 30 June 2013	Year ended 31 December 2013
Sales[1]	**£529m**	£657m	£1,243m
Underlying EBITA[2]	**£47m**	£53m	£115m
Return on sales	**8.9%**	8.1%	9.3%
Cash inflow[3]	**£24m**	£56m	£118m
Funded order intake[1]	**£616m**	£610m	£1,247m
Order backlog[1,4]	**£0.8bn**	£0.9bn	£0.7bn

Financial performance

In aggregate, sales[1] reduced by 13% to $883m (£529m). The US business saw a further 22% decrease driven largely by reduced budgets at the sector's two largest customers along with further reductions in analysis support on Counter-Improvised Explosive Device activity in Afghanistan. Growth in the Applied Intelligence business was 7%.

Despite the top line performance, margins were improved to 8.9%.

Cash flow[3] performance includes the capital costs of the replacement Enterprise Resource Planning system and investment in the Global Delivery Centre in Malaysia in the Applied Intelligence business.

Order backlog[1,4] increased to £0.8bn. Despite the first half top line pressures, backlog[1,4] in the US business grew by 8% on imagery analysis and cyber support awards. In the Applied Intelligence business, backlog[1,4] grew by 25% to £328m.

Operational performance

Intelligence & Security

In all three lines of business, Intelligence & Security has continued to be impacted by government budget reductions and the withdrawal of US troops from Afghanistan. Whilst the US services market continues to experience significant delays in procurement awards and increases in the number of award protests, customers continue to look for solutions to address big data challenges and opportunities to achieve efficiencies in IT services through consolidation and cloud computing, areas in which the US business has deep domain expertise.

Global Analysis and Operations

In the market for Full Motion Video and Intelligence, Surveillance and Reconnaissance analysis, the business has ongoing contracts worth over $400m (£234m) representing over 400 analysts supporting mission critical activities.

Execution on the Combat Intelligence Augmentation Teams task order, which began in August 2013, continues to provide valuable augmentation and support, with over 270 security-cleared intelligence analysts deployed in Afghanistan alongside US defence personnel. Due to the withdrawal of US troops from Afghanistan, the number of intelligence analyst staff on the programme is expected to be reduced by the end of the year.

GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance)

The business continues to mature its capabilities in Activity-Based Intelligence (ABI) which provides the intelligence and defence communities with increasingly automated, efficient and reliable data processing and management tools to transform big data into actionable intelligence. The business achieved at least 95% award fees on its ABI contracts during the period and submitted a $32m (£19m) Engineering Change Proposal in June, with authorisation to proceed expected in the third quarter.

In May, the business delivered the first software release for testing of the Mobility Air Force Automated Flight Planning Service programme and received authorisation to proceed on the next development phase.

The business' XTS® Guard was selected by the US Defense Information Systems Agency as an enterprise-wide security standard to ensure the agency's ability to share information securely among authorised Department of Defense users and across the Global Information Grid.

In the period, the National Geospatial-Intelligence Agency awarded the business a five-year contract with an estimated total value of $335m (£196m) to support its dynamic Map of the World project, which is giving US military leaders clearer on-the-ground intelligence pictures to enhance situational awareness and mission planning.

IT Solutions

The business continues to provide global networking solutions in US Korea Command and US Africa Command under the Next-Generation Desktop Environment programme, as well as execute under the ongoing Solutions for the Information Technology Enterprise and Centralised Operations, Maintenance and Management Information Technology indefinite delivery contracts.

The business continues to support the US High Performance Computing Infrastructure Group, providing architecture, installation and administration for a complex networking environment supporting multiple network enclaves and high-speed data centre access to more than 3,000 users.

In May, BAE Systems was awarded a position on the US Department of Homeland Security's $22bn (£13bn) Enterprise Acquisition Gateway for Leading Edge Solutions II multiple-award contract. This position allows the business to pursue task orders to provide a full range of IT solutions and services.

Applied Intelligence

The business continues to grow through the provision of solutions which protect and enhance the operations of governments and commercial organisations in the areas of cyber security, financial crime prevention, communications intelligence and digital transformation.

The business continues to invest in building its skills base. Over 40% of BAE Systems' UK graduate intake will join the Applied Intelligence business. The Global Delivery Centre in Malaysia now has over 100 employees supporting product development and customer project delivery.

Cyber Security continues to grow, building on its strong relationship with the UK government, with recent orders including a £7m, multi-year contract to address the UK Ministry of Defence's complex information assurance challenges.

New orders for the CyberReveal™ cyber threat monitoring solution have been received in the US and Europe, with continued demand from global financial institutions.

The IndustrialProtect™ solution, launched in 2013, which protects organisations' industrial control systems, received a £3m order from a major global energy supplier.

Market interest in MobileProtect™, launched in 2013 alongside a five-year strategic partnership with Vodafone, continues to grow with a number of contracts already signed and multiple large enterprises currently trialling the service ahead of intended roll out. The business is also in discussions with a number of communications service providers regarding the launch of the service outside the UK.

The ***NetReveal®*** business provides enterprise risk, fraud and compliance solutions internationally. Demand for multi-year managed service solutions has increased, with NetReveal® OnDemand being selected by RSA in Canada to provide insurance fraud solutions on a five-year contract. Expansion continues in the capital markets sector through the 'unauthorised trading' solution launched last year. NetReveal® continues to be recognised as an industry-leading solution, being named 'Best-in-Class' in three out of four categories in the '2014 Know Your Customer' technology report by CEB TowerGroup.

Communications Solutions is a provider of end-to-end communications intelligence solutions to government and communications service providers and is addressing opportunities in Europe, the Middle East and Asia-Pacific regions. It continues to invest in capabilities to address customers' latest requirements based on the changing communications landscape.

The ***UK Services*** business provides consulting and systems integration services to major customers, with a particular focus on enabling digital transformation. Its success continues in the Service Integration and Applications Management market, with new and additional multi-year contracts worth £45m awarded in the period, including a new contract with the Highways Agency.

Looking forward

Efforts to reduce the US government's budget deficit are expected to continue to impact government spend. A bipartisan budget proposal was approved in December 2013 that mitigates the full impact of the Sequester for 2014 and 2015. The Group expects lower defence spending than previously programmed, but the cuts are not expected to be as significant or indiscriminate as they would have been under Sequestration.

Intelligence & Security is well-positioned to pursue opportunities in cyber, special operations and Intelligence, Surveillance and Reconnaissance, which remain priority activities in the US. Other avenues for growth exist across the intelligence analysis spectrum. The US business is also exploring international opportunities where its IT, cyber and analysis capabilities can be implemented by governments or in commercial markets.

Applied Intelligence has a growing order backlog and pipeline of opportunities, underpinning growth from both government and commercial sector customers.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.
4 Order backlog comprises funded and unfunded unexecuted customer orders.

REPORTING SEGMENTS: PLATFORMS & SERVICES (US)

Platforms & Services (US), with 17,400 employees[1], comprises the US-headquartered Land & Armaments business, with operations in the US, UK, Sweden and South Africa, and the US-based services and sustainment activities, including ship repair and munitions services.

	Six months ended 30 June 2014	Six months ended 30 June 2013	Year ended 31 December 2013
Sales[1]	**£1,662m**	£2,085m	£4,196m
Underlying EBITA[2]	**£105m**	£182m	£265m
Return on sales	**6.3%**	8.7%	6.3%
Cash inflow/(outflow)[3]	**£109m**	£(89)m	£192m
Funded order intake[1]	**£1,338m**	£1,424m	£3,421m
Order backlog[1,4]	**£5.4bn**	£7.8bn	£7.4bn

Financial performance

Land & Armaments

Sales[1] in the first half year reduced by 24% to $1.3bn (£0.8bn) or 14% after adjusting for the transfer out of the UK Munitions business (sales in the six months ended 30 June 2013 of $193m (£125m)). As expected, Bradley reset activity has almost halved, the Medium Mine Protected Vehicle production contract has completed and deliveries under US M777 lightweight howitzer contracts have largely traded out.

Despite the expected top line reductions, the business has outperformed at the margin level, delivering a return on sales of 10.9% (2013 9.5%) through strong programme execution and cost reduction.

Cash flow[3] was significantly improved compared to last year, with more than 100% profit conversion.

Order backlog[1,4] of $4.4bn (£2.6bn) reduced in line with the sales traded after adjusting for the transfer out of the UK Munitions business (31 December 2013 $2.2bn (£1.3bn)).

Support Solutions

Sales[1] of $1.5bn (£0.9bn) in the first half year were in line with expectations with good volumes in naval ship repair activity.

Return on sales in the period was at just 2.5% (2013 8.0%). In addition to the lower margins arising from last year's issues on the Radford Army Ammunition Plant contract, a further £12m of charges have had to be taken on commercial shipbuilding programmes.

Order backlog[1,4] reduced to $4.8bn (£2.8bn) on the trading of sales under the five-year US Navy Multi-Ship, Multi-Option ship repair contracts and ordnance programmes. The re-compete for the Hawaiian contract was secured in the first half.

Operational performance

Land & Armaments

US Combat Vehicles

The business continued its campaign to sustain key combat vehicle industrial base capabilities in line with the US Army's evolving requirements.

The business is achieving all milestones on the $195m (£114m) M109A7 self-propelled howitzer and M992A3 ammunition carrier (formerly referred to as the Paladin Integrated Management programme) Low-Rate Initial Production contract awarded in 2013.

Work on the Joint Light Tactical Vehicle programme was transitioned successfully from the Sealy, Texas, plant, which closed in June. BAE Systems is working with Lockheed Martin on the Low-Rate Initial Production bid, which, if successful, would be undertaken at Lockheed Martin's Camden, Arkansas, facility, with cab production at BAE Systems' York, Pennsylvania, facility.

The business submitted its bid for the US Army's Armoured Multi-Purpose Vehicle in May. A major competitor has recently withdrawn from this valuable competition to replace the US Army's large fleet of M113 vehicles. The Army plans to award a single initial contract for the first phase, Engineering and Manufacturing Development, around the end of the year.

The US Marine Corps has revised its amphibious strategy, creating the Amphibious Combat Vehicle (ACV) 1.1 programme, for which BAE Systems has a candidate vehicle to address the customer requirement.

In May, the business was awarded an initial $12m (£7m) contract by the US Marine Corps to provide engineering design and development work related to survivability upgrades for the AAV7A1 Assault Amphibious Vehicle.

Funding for the Ground Combat Vehicle programme has been significantly reduced by the customer such that only a small amount of funds have been set aside for long-term development activities.

Weapon Systems

The US Navy displayed a railgun developed by BAE Systems aboard a Joint High Speed Vessel during July's International Electromagnetic Launch Technology Symposium in San Diego.

In the period, the business was awarded a contract for four 57mm Mk3 naval guns for an international customer.

The process of mothballing the M777 howitzer production line in the UK until further orders are secured has been completed. The Karlskoga, Sweden, facility will complete a 25% headcount reduction during the third quarter.

BAE Systems Hägglunds

The first upgraded CV90 combat vehicle for Norway was delivered in February.

Delivery of a new variant of the CV90 Armadillo was made to the Danish Army for competitive evaluation in support of their armoured personnel carrier requirement.

In May, the business entered into a teaming agreement with Rheinmetall Canada Inc. to offer the BvS10 all-terrain vehicle for the Canadian Marginal Terrain Vehicle programme.

FNSS

FNSS, BAE Systems' Turkish joint venture, continues production work on the $559m (£327m) programme to produce 259 8x8 wheeled armoured vehicles for the Royal Malaysian Army. Deliveries on the programme are scheduled through to 2018.

First vehicles under the $360m (£210m) contract from the Royal Saudi Land Forces for the upgrade of 320 M113 tracked armoured personnel carriers are scheduled for delivery in the second quarter of 2015.

The business submitted a proposal for the Oman Wheeled Armoured Personnel Carrier programme via its FNSS joint venture and contract award decision is expected later in 2014.

Support Solutions

The commercial shipbuilding business continued to experience challenges on a number of ongoing contracts.

The US-based ship repair business continued to perform well and received a Multi-Ship, Multi-Option contract for the Hawaii shipyard worth up to $200m (£117m) over five years to maintain, repair and upgrade US Navy ships.

Operational challenges under the Radford Army Ammunition Plant contract continued to be addressed in the period, and negotiations with the customer to adjust funding and other elements of this contract are ongoing.

The business is meeting all requirements in its second year of the $780m (£456m), five-year US Army contract to operate and manage the Holston Army Ammunition Plant in the US and purchase explosives from the plant. The business has successfully managed and operated the plant for the last 16 years.

In December 2013, the Letter of Offer and Acceptance was finalised between the Republic of Korea and the US government, down-selecting BAE Systems to upgrade avionics and electronic systems and perform systems integration on more than 130 F-16 aircraft. Phase one of the contract was received in May, valued at approximately $140m (£82m), and work has begun on the initial aircraft in Fort Worth, Texas. Phase two is expected in the second half of the year, bringing the total value of the programme to approximately $1.3bn (£0.8bn).

Under the $534m (£312m), eight-year US Air Force contract received in 2013 to maintain the readiness of Minuteman III intercontinental ballistic missiles in the US, all transition activities have been completed to assume lead integration support contractor role.

In February, the US Air Force Space Command awarded BAE Systems a further three-year contract extension to maintain its Solid State Phased Array Radar System, space radars used for missile warning and space surveillance operations, raising the value of the contract to approximately $540m (£316m).

In April, BAE Systems was informed that it had not been awarded the Automated Installation Entry III contract, which would have extended its current work in support of US Army installation security. The award is under protest by multiple parties and will be re-competed as a new procurement.

Looking forward

Efforts to reduce the US government's budget deficit are expected to continue to impact government spend. A bipartisan budget proposal was approved in December 2013 that mitigates the full impact of the Sequester for 2014 and 2015. The Group expects lower defence spending than previously programmed, but the cuts are not expected to be as significant or indiscriminate as they would have been under Sequestration.

In the near term, Land & Armaments continues to operate in a challenging environment. To remain viable in the future, the business is investing to protect franchise programmes, including Bradley and the CV90 family, and establish new franchise programmes, such as the M109A7/M992A3 programme (previously referred to as the Paladin Integrated Management programme). The US Army's Armoured Multi-Purpose Vehicle is the future franchise programme that would help to sustain the Group's combat vehicle manufacturing base in the US. In addition, the business continues to offer export products to international markets and invest in new technology, such as directed energy weapons and hybrid electric drives for combat vehicles.

Whilst potential cancellations and delays in new programmes could affect the business, Support Solutions may be able to offset the impact through additional opportunities to sustain and modernise existing platforms.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3 Net cash inflow/(outflow) from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.
4 Order backlog comprises funded and unfunded unexecuted customer orders.

REPORTING SEGMENTS: PLATFORMS & SERVICES (UK)

Platforms & Services (UK), with 29,400 employees[1], comprises the Group's UK-based air, maritime, combat vehicle, munitions and certain shared services activities.

	Six months ended 30 June 2014	Six months ended 30 June 2013[4]	Year ended 31 December 2013
Sales[1]	**£2,844m**	£3,231m	£6,890m
Underlying EBITA[2]	**£393m**	£386m	£879m
Return on sales	**13.8%**	11.9%	12.8%
Cash (outflow)/inflow[3]	**£(201)m**	£(411)m	£59m
Funded order intake[1]	**£1,612m**	£2,385m	£5,979m
Order backlog[1]	**£20.4bn**	£20.5bn	£20.3bn

Financial performance

Sales[1] of £2.8bn reduced by 12% compared to 2013 or 15% after adjusting for the transfer in from Land & Armaments of the UK Munitions business (sales in the six months ended 30 June 2013 of £125m). Typhoon aircraft deliveries have a significant second half bias. Under the Saudi Arabian Salam contract, there were four aircraft delivered in the first half, with eight scheduled for the second half. On the European programme, there were eight deliveries in the first half, with 22 scheduled for the second half as it transitions to deliveries of Tranche 3 standard aircraft.

The return on sales of 13.8% seen in the first half of 2014 benefited from strong programme execution and accelerated risk reduction on the European Typhoon production contract as Tranche 2 aircraft deliveries move towards completion.

As expected, the £0.2bn cash outflow[3] in the period reflects the consumption of customer advances on the Omani Typhoon and Hawk programme, the European Typhoon contract and the Saudi training aircraft contract.

Order backlog[1] reduced to £20.4bn from £21.6bn after adjusting for the transfer in of the UK Munitions business (31 December 2013 £1.3bn) primarily on the trading of Typhoon aircraft, Indian Hawks and aircraft carriers.

Operational performance

Military Air & Information

In the period, deliveries of eight Typhoon Tranche 2 aircraft to the four partner nations were made. Cumulative aircraft deliveries are now 211 of the contracted 236. In addition to a planned ten Tranche 2 aircraft deliveries, 12 Tranche 3 aircraft are also planned to be delivered in the second half of 2014.

In July, BAE Systems was awarded a £72m, three-year contract by the UK Ministry of Defence to de-risk E-Scan radar development for the Royal Air Force's Typhoon aircraft fleet ahead of the award of a full-scale development contract.

Progress continues on the Oman Typhoon and Hawk contract with the first aircraft deliveries scheduled for 2017.

The business supports its UK and European customers' Typhoon and Tornado aircraft and their operational commitments through availability-based service contracts. A £125m contract extension was received in the period to provide support to the Royal Air Force's Tornado GR4 fleet until aircraft retirement in 2019.

On the F-35 Lightning II programme, production under the sixth and seventh Low-Rate Initial Production (LRIP) contracts remains on schedule, with a total of 21 aft fuselage assemblies delivered during the period. Price negotiations with Lockheed Martin for the eighth LRIP contract have been completed, with full order intake anticipated to follow later in 2014. Bidding activity in respect of the ninth LRIP contract is expected to commence during the third quarter.

Support continues to be provided to users of Hawk trainer aircraft around the world. The Indian Navy has received a further three Hawk aircraft from Hindustan Aeronautics Limited, built under the Batch 2 licence for 57 aircraft. Commercial discussions are ongoing for an additional 20 Hawk aircraft for the Indian Air Force's aerobatic display team.

Working jointly with Dassault Aviation, progress is being made in maturing and demonstrating critical technology and operational aspects for an Unmanned Combat Air System. In January, it was announced that there would be further joint UK/French Future Combat Air System technology development under a two-year feasibility study worth £120m for the participating companies.

Taranis, the stealthy unmanned combat air vehicle demonstrator designed and built by BAE Systems with UK industry partners and the Ministry of Defence, has successfully completed a second phase of flight testing. During these latest tests, Taranis flew in a fully stealthy configuration, making it virtually invisible to radar.

Maritime

In November 2013, BAE Systems announced that it proposed to consolidate its UK shipbuilding operations in Glasgow and that shipbuilding operations at Portsmouth would cease in the second half of 2014, with a potential employee reduction of up to 1,775. Constructive consultation with the trade unions and other employee representative bodies is in place. The restructuring is progressing to plan, continuing through to 2016.

BAE Systems has continued to negotiate contracts with the UK Ministry of Defence to enact the restructuring of its naval ships business. In the first half of the year, contracts were signed for the revised target cost arrangements for the delivery of the Queen Elizabeth class aircraft carriers, initial long lead funding for the procurement of the three new Offshore Patrol Vessels and the recovery of associated rationalisation costs.

On the aircraft carrier programme, HMS Queen Elizabeth was officially named by Her Majesty The Queen at Rosyth in July. The second ship block build programme is some 70% complete. Under the new target cost arrangements, the industrial participants' fee includes a 50:50 risk share arrangement providing greater cost performance incentives.

The assessment phase contract for the Type 26 is progressing and there are now over 650 employees working on the programme.

On the Khareef class corvettes for Oman, the third ship achieved interim acceptance on schedule in May. Final acceptance of the first two ships is planned for later in 2014, with the third ship planned for 2015.

Negotiations are at an advanced stage on the five-year Maritime Support Delivery Framework contract for the delivery of services at Portsmouth Naval Base.

The Type 45 support contract met all ship deployment dates in the period. In June, the UK Ministry of Defence awarded BAE Systems a £70m contract to manage the support, maintenance and upgrade of the Type 45 destroyers at Portsmouth Naval Base and on all their operations in the UK and globally from July 2014 to November 2016.

The Advanced Radar Target Indication Situational Awareness Navigation (ARTISAN) 3D radar programme is on schedule with two Type 23 frigates fitted and deployed with the system.

The four-year Spearfish torpedo upgrade assessment phase has progressed to the stage where discussions are now underway to extend the contract into demonstration and full manufacture.

HMS Astute and HMS Ambush, the first and second of class attack submarines for the Royal Navy, achieved operational handover in 2013. Artful, the third of class, was launched in May.

Progress continues on the design and development phase of the Successor submarine programme, the potential replacement to the Vanguard class fleet, with more than 1,300 people now employed on the programme.

Combat Vehicles (UK)

In the period, the final 17 of 60 Terrier combat engineering vehicles were delivered to the initial build standard. All 60 vehicles will now pass through a retrofit programme to meet final acceptance build standard during the second half of 2014. The Newcastle facility will close by the end of the year following the completion of vehicle deliveries.

Orders totalling £34m for ongoing support activity were received in the period.

Munitions

The business submitted the last five-year pricing proposal of its 15-year Munitions Acquisition Supply Solution contract with the UK Ministry of Defence during the period.

Transformation of the munitions facilities under the £200m capital programme is due to complete in the second half of the year.

Looking forward

Platforms & Services (UK) has a strong order backlog of long-term committed programmes and an enduring support business.

In Military Air & Information, sales are underpinned by aircraft production on Typhoon and F-35 Lightning II, and in-service support for existing and legacy combat and Hawk trainer aircraft. There are a number of opportunities to secure future Typhoon export sales.

In Maritime, sales are underpinned by the design and subsequent build of the Successor submarine and Type 26 frigate, and the build of the Queen Elizabeth class carrier and Astute class submarine. The through-life support of the surface ship platforms, including the Type 45 destroyer, together with their associated command and combat systems, provides a sustainable business in technical services and mid-life upgrades.

In Combat Vehicles (UK), sales beyond the Terrier programme are expected to be derived from future support and upgrade of legacy platforms.

The Munitions business is underpinned by the 15-year Munitions Acquisition Supply Solution partnering agreement with the UK Ministry of Defence, together with a number of international contracts and potential opportunities.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3 Net cash (outflow)/inflow from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.
4 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.

REPORTING SEGMENTS: PLATFORMS & SERVICES (INTERNATIONAL)

Platforms & Services (International), with 14,100 employees[1], comprises the Group's businesses in Saudi Arabia, Australia and Oman, together with its 37.5% interest in the pan-European MBDA joint venture.

	Six months ended 30 June 2014	Six months ended 30 June 2013	Year ended 31 December 2013
Sales[1]	**£1,576m**	£1,654m	£4,063m
Underlying EBITA[2]	**£157m**	£165m	£429m
Return on sales	**10.0%**	10.0%	10.6%
Cash inflow/(outflow)[3]	**£541m**	£(221)m	£(189)m
Funded order intake[1]	**£761m**	£4,178m	£7,221m
Order backlog[1]	**£11.4bn**	£11.9bn	£12.3bn

Financial performance

Excluding the exchange translational impact of sterling against the Euro and Australian dollar, sales[1] for the first six months of £1.6bn are unchanged from 2013.

Underlying EBITA[2] was £157m, giving a consistent return on sales of 10.0%.

There was an operating cash inflow[3] of £541m which includes a net £349m from the sale and leaseback, and initial rentals, of the two Saudi residential compounds.

Whilst order backlog[1] has reduced from last year end's high following the awards in 2013 of the five-year support contracts and further weapons procurement, orders totalling £1.3bn are being finalised with the Saudi customer.

Operational performance

Saudi Arabia

Through the build-up of the Typhoon aircraft fleet and the ongoing development of the in-country industrial base, the Group remains committed to developing a greater indigenous capability in Saudi Arabia.

On the Salam Typhoon programme, UK final assembly of 72 Typhoon aircraft continues. In February, discussions on price escalation reached agreement with the Saudi Arabian government. At 30 June 2014, 38 aircraft had been delivered to the customer. Work continues to expand the capability on the aircraft, including finalising additional orders of £1.3bn.

Under the £1.8bn, five-year Typhoon support contract received in 2013, flying hours and key performance indicators are meeting contracted levels. The mobilisation of the scheduled maintenance and upgrade programme under a contract received in 2013 is complete and the first of 30 aircraft has entered the programme.

Under the Saudi British Defence Co-operation Programme, the business supports the operational capability of both the Royal Saudi Air Force (RSAF) and Royal Saudi Naval Forces (RSNF). Under a £1.6bn contract awarded in 2012 to upgrade the RSAF's training aircraft, the first Pilatus PC-21 aircraft were delivered in June and Hawk production is on schedule. Support continues to be provided to the RSAF through five-year contracts awarded in 2012 worth £3.4bn.

The orders received in 2013 for the upgrade of Tornado aircraft and procurement of weapons have been mobilised, and are proceeding to plan.

Under the RSNF minehunter mid-life update programme, the second ship is scheduled for acceptance back into the RSNF fleet in early 2015.

Australia

The first Landing Helicopter Dock (LHD), HMAS Canberra, has taken part in successful harbour and first sea trials, with delivery of the ship scheduled for the second half of 2014.

The hull for the second LHD, HMAS Adelaide, arrived at Williamstown shipyard from Spanish subcontractor, Navantia, in February. The superstructure and hull have been consolidated and outfitting activity has commenced. Delivery of the ship is scheduled for the second half of 2015.

On the Air Warfare Destroyer programme, construction work continues on the additional blocks contracted, with two now complete. Further block awards for the final ship are anticipated in the second half of the year.

Work is underway at the Henderson shipyard to upgrade the third ANZAC class frigate, HMAS ANZAC, contracted as part of the Anti-Ship Missile Defence follow-on contract. The second ship, HMAS Arunta, was delivered back to the customer in June ahead of sea trials and HMAS ANZAC is scheduled to be delivered in the second half of 2014.

Negotiations are ongoing with the Commonwealth on the de-scoping of the JP 2008 Phase 3F programme which provides strategic and tactical satellite communications capabilities to support Australian Defence Force operations.

Oman

Following the signature of the contract to supply 12 Typhoon and eight Hawk aircraft in 2012, the first aircraft have entered production with deliveries to the customer commencing in 2017.

MBDA

In January, the UK and French governments signed an agreement worth €600m (£480m) for the joint development and production of the MBDA Future Anti-Ship Guided Weapon – Anti-Navire Léger missile for their armed forces.

Following successful completion of the Meteor development programme, cumulative deliveries of production-standard missiles totalled 62 out of almost 1,100 for the six partner nation customers at 30 June 2014.

In July, MBDA received a £250m contract to supply the Advanced Short Range Air-to-Air Missile (ASRAAM) for India’s Jaguar aircraft fleet.

Looking forward

The Group expects to sustain its prime contract position and long-term presence in the Kingdom of Saudi Arabia through delivering current programmes and developing new business in support of the Saudi military forces. In June, BAE Systems announced a reorganisation of its portfolio of interests in a number of industrial companies in Saudi Arabia and an enhancement of its existing relationship with Riyadh Wings Aviation Academy LLC. The reorganisation is expected to enhance the growth prospects of this portfolio of businesses and reinforce an ongoing commitment to support the national agenda of developing an indigenous defence industry, supporting skills and technology development, and increasing local employment.

As part of the Australian federal budget announcements in May, the defence budget was increased by 8% for the 2014/15 fiscal year. The Australian government’s election commitment is to increase defence expenditure to 2% of Gross Domestic Product within a decade. The Group is continuing to explore and secure opportunities in adjacent markets, particularly in the oil and gas industry in Western Australia.

In Oman, the business continues to focus on strengthening its close relationship with the Royal Oman Air Force, Navy and Army to address their future requirements.

MBDA continues to build on the effective partnerships it has established with its domestic customers and is pursuing actively a significant number of air defence export opportunities. The business continues to support the various aircraft programme campaigns around the world through responding to associated weapon requirements.

1 Including share of equity accounted investments.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3 Net cash inflow/(outflow) from operating activities after capital expenditure (net) and financial investment, and dividends from equity accounted investments.

RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE HALF-YEARLY FINANCIAL REPORT

Each of the directors (as detailed below) confirms that to the best of his/her knowledge:

- The condensed set of financial statements has been prepared in accordance with IAS 34, Interim Financial Reporting, as adopted by the European Union.
- The interim management report includes a fair review of the information required by:
  (a) DTR 4.2.7R of the Disclosure and Transparency Rules (DTR), being an indication of important events that have occurred during the first six months of the financial year and their impact on the condensed set of financial statements; and a description of the principal risks and uncertainties for the remaining six months of the year; and
  (b) DTR 4.2.8R of the DTR, being related party transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or performance of the Company during that period; and any changes in the related party transactions described in the last annual report that could do so.

For and on behalf of the directors:

Sir Roger Carr
Chairman

30 July 2014

Directors

Sir Roger Carr	Chairman
Ian King	Chief Executive
Jerry DeMuro	President and Chief Executive Officer of BAE Systems, Inc.
Peter Lynas	Group Finance Director
Paul Anderson	Non-executive director
Harriet Green	Non-executive director
Chris Grigg	Non-executive director
Paula Rosput Reynolds	Non-executive director
Nick Rose	Non-executive director
Carl Symon	Non-executive director
Ian Tyler	Non-executive director

INDEPENDENT REVIEW REPORT TO BAE SYSTEMS PLC

Introduction

We have been engaged by the Company to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2014 which comprises the Condensed Consolidated Income Statement, the Condensed Consolidated Statement of Comprehensive Income, the Condensed Consolidated Cash Flow Statement, the Condensed Consolidated Balance Sheet, the Condensed Consolidated Statement of Changes in Equity and the related explanatory notes. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the Disclosure and Transparency Rules (the DTR) of the UK's Financial Conduct Authority (the UK FCA). Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the DTR of the UK FCA.

The annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union (EU). The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with IAS 34, Interim Financial Reporting, as adopted by the EU.

Our responsibility

Our responsibility is to express to the Company a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity issued by the Auditing Practices Board for use in the UK. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2014 is not prepared, in all material respects, in accordance with IAS 34 as adopted by the EU and the DTR of the UK FCA.

Ian Starkey
For and on behalf of KPMG LLP
Chartered Accountants
15 Canada Square
London E14 5GL

30 July 2014

CONDENSED CONSOLIDATED INCOME STATEMENT

	Notes	Six months ended 30 June 2014 £m	Six months ended 30 June 2014 £m	Six months ended 30 June 2013[1] £m	Six months ended 30 June 2013[1] £m
Continuing operations					
Combined sales of Group and share of equity accounted investments	2		**7,611**		8,487
Less: share of sales of equity accounted investments	2		**(489)**		(496)
Revenue	2		**7,122**		7,991
Operating costs			**(6,493)**		(7,338)
Other income			**46**		55
Group operating profit			**675**		708
Share of results of equity accounted investments			**14**		44
Underlying EBITA[2]		**802**		867	
Non-recurring items[3]		**–**		4	
EBITA		**802**		871	
Amortisation		**(88)**		(96)	
Impairment		**–**		(4)	
Financial expense of equity accounted investments	3	**(21)**		(2)	
Taxation expense of equity accounted investments		**(4)**		(17)	
Operating profit	2		**689**		752
Financial income		**165**		278	
Financial expense		**(313)**		(499)	
Finance costs	3		**(148)**		(221)
Profit before taxation			**541**		531
Taxation expense			**(107)**		(116)
Profit for the period			**434**		415
Attributable to:					
Equity shareholders			**429**		411
Non-controlling interests			**5**		4
			434		415
Earnings per share	4				
Basic earnings per share			**13.5p**		12.7p
Diluted earnings per share			**13.5p**		12.6p

1 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3 Non-recurring items represents profit on disposal of businesses £nil (2013 £4m).

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	Six months ended 30 June 2014			Six months ended 30 June 2013		
	Other reserves £m	Retained earnings £m	Total £m	Other reserves £m	Retained earnings[1] £m	Total[1] £m
Profit for the period	**–**	**434**	**434**	–	415	415
Other comprehensive income						
Items that will not be reclassified to the income statement:						
Remeasurements on defined benefit pension schemes:						
Subsidiaries	**–**	**(308)**	**(308)**	–	430	430
Equity accounted investments	**–**	**(19)**	**(19)**	–	(16)	(16)
Tax on items that will not be reclassified to the income statement	**–**	**69**	**69**	–	(167)	(167)
Items that may be reclassified to the income statement:						
Currency translation on foreign currency net investments:						
Subsidiaries	**(161)**	**–**	**(161)**	307	–	307
Equity accounted investments	**(22)**	**–**	**(22)**	11	–	11
Reclassification of cumulative currency translation reserve on disposal	**–**	**–**	**–**	(8)	–	(8)
Amounts (charged)/credited to hedging reserve	**(45)**	**–**	**(45)**	69	–	69
Tax on items that may be reclassified to the income statement	**10**	**–**	**10**	(16)	–	(16)
Total other comprehensive income for the period (net of tax)	**(218)**	**(258)**	**(476)**	363	247	610
Total comprehensive income for the period	**(218)**	**176**	**(42)**	363	662	1,025
Attributable to:						
Equity shareholders	**(217)**	**171**	**(46)**	364	658	1,022
Non-controlling interests	**(1)**	**5**	**4**	(1)	4	3
	(218)	**176**	**(42)**	363	662	1,025

1 Restated for the updated fair value of longevity swaps following consideration of the impact of the adoption of IAS 19 (revised 2011), Employee Benefits, and IFRS 13, Fair Value Measurement.

NOTES TO THE CONDENSED HALF-YEARLY FINANCIAL STATEMENTS

1. Preparation

Basis of preparation and statement of compliance
These condensed consolidated half-yearly financial statements of BAE Systems plc (the Group) have been prepared in accordance with International Accounting Standard (IAS) 34, Interim Financial Reporting. The annual consolidated financial statements of the Group are prepared in accordance with EU-endorsed International Financial Reporting Standards (IFRSs). These condensed consolidated half-yearly financial statements do not comprise statutory accounts within the meaning of Section 435 of the Companies Act 2006, and should be read in conjunction with the Annual Report 2013. The comparative figures for the year ended 31 December 2013 are not the Group's statutory accounts for that financial year. Those accounts have been reported upon by the Group's auditors and delivered to the registrar of companies. The report of the auditors was unqualified, did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and did not contain statements under Section 498 (2) or (3) of the Companies Act 2006.

Except as described below, the accounting policies adopted in the preparation of these condensed consolidated half-yearly financial statements to 30 June 2014 are consistent with the accounting policies applied by the Group in its consolidated financial statements as at, and for the year ended, 31 December 2013 as required by the Disclosure and Transparency Rules of the UK's Financial Conduct Authority.

Changes in accounting policies
A number of new EU-endorsed standards and amendments to existing standards, which are listed below, are effective for periods beginning on or after 1 January 2014 and have been applied in preparing these consolidated financial statements. With the exception of new disclosure requirements, none of these have an impact on the consolidated financial statements of the Group.

New standards and amendments to existing standards	Effective for periods beginning on or after
IFRS 10, Consolidated Financial Statements	1 January 2014
IFRS 11, Joint Arrangements	1 January 2014
IFRS 12, Disclosure of Interests in Other Entities	1 January 2014
IAS 27, Separate Financial Statements (revised 2011)	1 January 2014
IAS 28, Investments in Associates and Joint Ventures (revised 2011)	1 January 2014

There are no EU-endorsed IFRSs or IFRIC interpretations that are not yet effective that are expected to have a material impact on the Group.

NOTES TO THE CONDENSED HALF-YEARLY FINANCIAL STATEMENTS – CONDENSED CONSOLIDATED INCOME STATEMENT

2. Segmental analysis

Sales and revenue by reporting segment

	Combined sales of Group and share of equity accounted investments		Less: sales by equity accounted investments		Add: sales to equity accounted investments		Revenue	
	Six months ended 30 June 2014 £m	Six months ended 30 June 2013[1] £m	**Six months ended 30 June 2014 £m**	Six months ended 30 June 2013 £m	**Six months ended 30 June 2014 £m**	Six months ended 30 June 2013 £m	**Six months ended 30 June 2014 £m**	Six months ended 30 June 2013[1] £m
Electronic Systems	**1,108**	1,194	**(36)**	(30)	**36**	30	**1,108**	1,194
Cyber & Intelligence	**529**	657	**–**	–	**–**	–	**529**	657
Platforms & Services (US)	**1,662**	2,085	**(36)**	(35)	**–**	–	**1,626**	2,050
Platforms & Services (UK)	**2,844**	3,231	**(428)**	(517)	**382**	484	**2,798**	3,198
Platforms & Services (International)	**1,576**	1,654	**(297)**	(297)	**–**	–	**1,279**	1,357
HQ	**127**	145	**(127)**	(145)	**–**	–	**–**	–
	7,846	8,966	**(924)**	(1,024)	**418**	514	**7,340**	8,456
Intra-group sales/revenue	**(235)**	(479)	**–**	–	**17**	14	**(218)**	(465)
	7,611	8,487	**(924)**	(1,024)	**435**	528	**7,122**	7,991

Reporting segment result

	Underlying EBITA[2]		Non-recurring items[3]		Amortisation of intangible assets		Impairment of intangible assets		Reporting segment result	
	Six months ended 30 June 2014 £m	Six months ended 30 June 2013[1] £m	**Six months ended 30 June 2014 £m**	Six months ended 30 June 2013 £m	**Six months ended 30 June 2014 £m**	Six months ended 30 June 2013 £m	**Six months ended 30 June 2014 £m**	Six months ended 30 June 2013 £m	**Six months ended 30 June 2014 £m**	Six months ended 30 June 2013[1] £m
Electronic Systems	**143**	156	**–**	–	**(7)**	(7)	**–**	(4)	**136**	145
Cyber & Intelligence	**47**	53	**–**	–	**(28)**	(29)	**–**	–	**19**	24
Platforms & Services (US)	**105**	182	**–**	5	**(9)**	(12)	**–**	–	**96**	175
Platforms & Services (UK)	**393**	386	**–**	–	**(42)**	(45)	**–**	–	**351**	341
Platforms & Services (International)	**157**	165	**–**	(1)	**(2)**	(3)	**–**	–	**155**	161
HQ[4]	**(43)**	(75)	**–**	–	**–**	–	**–**	–	**(43)**	(75)
	802	867	**–**	4	**(88)**	(96)	**–**	(4)	**714**	771
Financial expense of equity accounted investments									**(21)**	(2)
Taxation expense of equity accounted investments									**(4)**	(17)
Operating profit									**689**	752
Finance costs									**(148)**	(221)
Profit before taxation									**541**	531
Taxation expense									**(107)**	(116)
Profit for the period									**434**	415

1 Re-presented on classification of the Regional Aircraft line of business as a continuing operation.
2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.
3 Non-recurring items represents profit on disposal of businesses £nil (2013 £4m).
4 In 2014, the HQ reporting segment includes a £30m benefit (2013 £nil) from re-assessment of a long-term liability and a £17m charge (2013 £32m) in respect of a US contract pricing dispute.

3. Finance costs

	Six months ended 30 June 2014 £m	Six months ended 30 June 2013 £m
Finance costs:		
Group	**(148)**	(221)
Share of equity accounted investments	**(21)**	(2)
	(169)	(223)
Analysed as:		
Underlying interest (expense)/income:		
Group	**(88)**	(98)
Share of equity accounted investments	**(1)**	3
	(89)	(95)
Other:		
Group:		
Net interest expense on retirement benefit obligations	**(76)**	(98)
Fair value and foreign exchange adjustments on financial instruments and investments	**16**	(25)
Share of equity accounted investments	**(20)**	(5)
	(169)	(223)

4. Earnings per share

	Six months ended 30 June 2014			Six months ended 30 June 2013		
	£m	Basic pence per share	Diluted pence per share	£m	Basic pence per share	Diluted pence per share
Profit for the period attributable to equity shareholders	**429**	**13.5**	**13.5**	411	12.7	12.6
(Deduct)/add back:						
Profit on disposal of businesses	**–**			(4)		
Net interest expense on retirement benefit obligations, post tax	**64**			78		
Fair value and foreign exchange adjustments on financial instruments and investments, post tax	**–**			19		
Amortisation and impairment of intangible assets, post tax	**70**			75		
Underlying earnings, post tax	**563**	**17.7**	**17.7**	579	17.9	17.8

	2014 Millions	2014 Millions	2013 Millions	2013 Millions
Weighted average number of shares used in calculating basic earnings per share	**3,175**	**3,175**	3,243	3,243
Incremental shares in respect of employee share schemes		**9**		10
Weighted average number of shares used in calculating diluted earnings per share		**3,184**		3,253

Underlying earnings per share is presented in addition to that required by IAS 33, Earnings per Share, to align the adjusted earnings measure with the performance measure reviewed by the directors. The directors consider that this gives a more appropriate indication of underlying performance.

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

	Notes	Six months ended 30 June 2014 £m	Six months ended 30 June 2013 £m
Profit for the period		**434**	415
Taxation expense		**107**	116
Share of results of equity accounted investments		**(14)**	(44)
Finance costs		**148**	221
Depreciation, amortisation and impairment		**226**	255
(Profit)/loss on disposal of property, plant and equipment		**(4)**	5
Profit on disposal of investment property		**(3)**	(6)
Profit on disposal of businesses		**–**	(4)
Cost of equity-settled employee share schemes		**22**	26
Movements in provisions		**(124)**	(34)
Decrease in liabilities for retirement benefit obligations		**(143)**	(147)
Increase in working capital:			
Inventories		**(28)**	(59)
Trade and other receivables		**(125)**	(443)
Trade and other payables		**(526)**	(1,029)
Cash outflow from operating activities[1]		**(30)**	(728)
Interest paid		**(81)**	(88)
Taxation paid		**(65)**	(94)
Net cash outflow from operating activities		**(176)**	(910)
Dividends received from equity accounted investments		**13**	10
Interest received		**5**	7
Purchases of property, plant and equipment, and investment property		**(100)**	(105)
Purchases of intangible assets		**(28)**	(11)
Proceeds from sale of property, plant and equipment, and investment property	5	**433**	20
Purchase of subsidiary undertakings (net of cash acquired)		**–**	(1)
Equity accounted investment funding		**(1)**	(1)
Proceeds from sale of subsidiary undertakings (net of cash disposed)		**–**	7
Net cash inflow/(outflow) from investing activities		**322**	(74)
Net purchase of own shares		**(237)**	(90)
Equity dividends paid	7	**(383)**	(380)
Dividends paid to non-controlling interests		**(2)**	(12)
Cash (outflow)/inflow from matured derivative financial instruments		**(57)**	33
Cash (outflow)/inflow from cash collateral		**(7)**	2
Cash outflow from repayment of loans		**(298)**	–
Net cash outflow from financing activities		**(984)**	(447)
Net decrease in cash and cash equivalents		**(838)**	(1,431)
Cash and cash equivalents at 1 January		**2,222**	3,334
Effect of foreign exchange rate changes on cash and cash equivalents		**(10)**	7
Cash and cash equivalents at end of period		**1,374**	1,910
Comprising:			
Cash and cash equivalents		**1,374**	1,919
Overdrafts		**–**	(9)
Cash and cash equivalents at end of period		**1,374**	1,910

1 See reconciliation to operating business cash flow on page 9.

CONDENSED CONSOLIDATED BALANCE SHEET

	Notes	30 June 2014 £m	31 December 2013 £m
Non-current assets			
Intangible assets		**9,527**	9,735
Property, plant and equipment	5	**1,593**	1,936
Investment property		**136**	135
Equity accounted investments		**248**	283
Other investments		**3**	3
Other receivables		**517**	477
Other financial assets		**37**	42
Deferred tax assets		**950**	901
		13,011	13,512
Current assets			
Inventories		**690**	680
Trade and other receivables including amounts due from customers for contract work		**3,054**	3,038
Current tax		**8**	8
Other financial assets		**74**	81
Cash and cash equivalents		**1,374**	2,222
Assets held for sale	5	**–**	140
		5,200	6,169
Total assets		**18,211**	19,681
Non-current liabilities			
Loans		**(2,459)**	(2,524)
Trade and other payables		**(1,035)**	(1,160)
Retirement benefit obligations	6	**(3,898)**	(3,665)
Other financial liabilities		**(70)**	(59)
Deferred tax liabilities		**(4)**	(7)
Provisions		**(473)**	(403)
		(7,939)	(7,818)
Current liabilities			
Loans and overdrafts		**(100)**	(402)
Trade and other payables		**(6,505)**	(7,074)
Other financial liabilities		**(94)**	(81)
Current tax		**(520)**	(497)
Provisions		**(277)**	(391)
		(7,496)	(8,445)
Total liabilities		**(15,435)**	(16,263)
Net assets		**2,776**	3,418
Capital and reserves			
Issued share capital		**88**	89
Share premium		**1,249**	1,249
Other reserves		**4,652**	4,868
Retained earnings – deficit		**(3,252)**	(2,825)
Total equity attributable to equity holders of the parent		**2,737**	3,381
Non-controlling interests		**39**	37
Total equity		**2,776**	3,418

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Attributable to equity holders of the parent						
	Issued share capital £m	Share premium £m	Other reserves[1] £m	Retained earnings £m	Total £m	Non-controlling interests £m	Total equity £m
At 1 January 2014	89	1,249	4,868	(2,825)	3,381	37	3,418
Profit for the period	–	–	–	429	429	5	434
Total other comprehensive income for the period	–	–	(217)	(258)	(475)	(1)	(476)
Share-based payments	–	–	–	22	22	–	22
Net purchase of own shares	(1)	–	1	(237)	(237)	–	(237)
Ordinary share dividends	–	–	–	(383)	(383)	(2)	(385)
At 30 June 2014	**88**	**1,249**	**4,652**	**(3,252)**	**2,737**	**39**	**2,776**
At 1 January 2013	90	1,249	5,079	(2,698)	3,720	54	3,774
Profit for the period	–	–	–	411	411	4	415
Total other comprehensive income for the period[2]	–	–	364	247	611	(1)	610
Share-based payments	–	–	–	26	26	–	26
Net purchase of own shares	(1)	–	1	(93)	(93)	–	(93)
Ordinary share dividends	–	–	–	(380)	(380)	(12)	(392)
At 30 June 2013[2]	89	1,249	5,444	(2,487)	4,295	45	4,340

1 The net decrease comprises translation reserve decrease £182m (2013 increase £311m), hedging reserve decrease £35m (2013 increase £53m) and capital redemption reserve increase £1m (2013 £1m).
2 Restated for the updated fair value of longevity swaps following consideration of the impact of the adoption of IAS 19 (revised 2011), Employee Benefits, and IFRS 13, Fair Value Measurement.

NOTES TO THE CONDENSED HALF-YEARLY FINANCIAL STATEMENTS – CONDENSED CONSOLIDATED BALANCE SHEET

5. Property, plant and equipment and assets held for sale

In the period, the Group completed the sale and leaseback of two properties in Saudi Arabia generating £441m in cash, of which £418m was received in the period. At 31 December 2013, one of the properties was included in property, plant and equipment and the other in assets held for sale.

6. Retirement benefit obligations

	UK £m	US and other £m	Total £m
Total IAS 19 deficit at 1 January 2014	(4,272)	(266)	(4,538)
Actual return on assets excluding amounts included in interest expense	209	169	378
Increase in liabilities due to changes in assumptions and experience	(523)	(239)	(762)
Additional contributions in excess of service cost	148	–	148
Recurring contributions above/(below) service cost	21	(6)	15
Net interest expense	(90)	(8)	(98)
Foreign exchange adjustments	–	12	12
Movement in US healthcare schemes	–	(1)	(1)
Total IAS 19 deficit at 30 June 2014	**(4,507)**	**(339)**	**(4,846)**
Allocated to equity accounted investments and other participating employers	1,109	–	1,109
Group's share of IAS 19 deficit excluding Group's share of amounts allocated to equity accounted investments and other participating employers at 30 June 2014	**(3,398)**	**(339)**	**(3,737)**
Represented by:			
Pension prepayments (within other receivables)	91	70	161
Retirement benefit obligations	(3,489)	(409)	(3,898)
	(3,398)	**(339)**	**(3,737)**

The net increase in liabilities due to changes in assumptions and experience reflects, in the UK, a 0.2 percentage point decrease in the real discount rate to 0.9% and, in the US, a 0.6 percentage point decrease in the nominal discount rate to 4.3%, partially offset by experience gains in the UK pension schemes.

Certain of the Group's equity accounted investments participate in the Group's defined benefit schemes as well as Airbus SAS, the Group's share of which was disposed of in 2006. As these schemes are multi-employer schemes, the Group has allocated a share of the IAS 19 pension deficit to its equity accounted investments and other participating employers using a consistent allocation method intended to reflect a reasonable approximation of their share of the deficit. The allocation method for all schemes is based on the BAE Systems Pension Scheme's schedule of contributions agreed with the sponsoring employers and trustees as part of the triennial funding valuations performed in 2011. The Group's share of the IAS 19 pension deficit allocated to the equity accounted investments is included in the balance sheet within equity accounted investments. In the event that an employer who participates in the Group's pension schemes fails or cannot be compelled to fulfil its obligations as a participating employer, the remaining participating employers are obliged to collectively take on its obligations. The Group considers the likelihood of this event arising as remote.

NOTES TO THE CONDENSED HALF-YEARLY FINANCIAL STATEMENTS – OTHER INFORMATION

7. Equity dividends

	Six months ended 30 June 2014 £m	Six months ended 30 June 2013 £m
Prior year final 12.1p dividend per ordinary share paid in the period (2013 11.7p)	**383**	380

The directors have declared an interim dividend of 8.2p per ordinary share (2013 8.0p), totalling £259m (2013 £258m). The dividend will be paid on 1 December 2014 to shareholders registered on 24 October 2014. The ex-dividend date is 23 October 2014.

Shareholders who do not at present participate in the Company's Dividend Reinvestment Plan and wish to receive the final dividend in shares rather than cash should complete a mandate form for the Dividend Reinvestment Plan and return it to the registrars no later than 10 November 2014.

8. Fair value measurement

Fair value of financial instruments
Certain of the Group's financial instruments are held at fair value.

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the balance sheet date.

The fair values of financial instruments held at fair value have been determined based on available market information at the balance sheet date, and the valuation methodologies listed below:

– the fair values of forward foreign exchange contracts are calculated by discounting the contracted forward values and translating at the appropriate balance sheet rates;

– the fair values of both interest rate and cross-currency swaps are calculated by discounting expected future principal and interest cash flows and translating at the appropriate balance sheet rates; and

– the fair values of loans and overdrafts have been estimated by discounting the future cash flows to net present values using appropriate market-based interest rates prevailing at 30 June.

Due to the variability of the valuation factors, the fair values presented at 30 June may not be indicative of the amounts the Group would expect to realise in the current market environment.

Fair value hierarchy
The fair value measurement hierarchy is as follows:

– Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities;

– Level 2 – Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

– Level 3 – Inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

Carrying amounts and fair values of certain financial instruments

	Carrying amounts	
	30 June 2014 £m	31 December 2013 £m
Financial instruments measured at fair value:		
Non-current		
Available-for-sale financial assets	**3**	3
Other receivables[1]	**218**	211
Other financial assets	**37**	42
Other financial liabilities	**(70)**	(59)
Loans	**(295)**	(307)
Trade and other payables[1]	**(236)**	(237)
Current		
Other financial assets	**74**	81
Other financial liabilities	**(94)**	(81)
Financial instruments not measured at fair value:		
Non-current		
Loans	**(2,164)**	(2,217)
Current		
Cash and cash equivalents	**1,374**	2,222
Loans and overdrafts	**(100)**	(402)

1 Represents US deferred compensation plan assets and liabilities.

Financial assets and liabilities in the Group's consolidated balance sheet are either held at fair value or their carrying value approximates to fair value, with the exception of loans, most of which are held at amortised cost.

The fair value of total loans estimated using market prices at 30 June 2014 is £2,811m (31 December 2013 £3,088m).

All of the financial assets and liabilities measured at fair value are classified as level 2 using the fair value hierarchy. There were no transfers between levels during the period.

9. Related party transactions

Transactions with related parties are shown on page 179 of the Annual Report 2013. The more significant transactions in the period are disclosed below:

	Six months ended 30 June 2014 £m	Six months ended 30 June 2013 £m
Sales to equity accounted investments	**435**	528
Purchases from equity accounted investments	**57**	55

	30 June 2014 £m	31 December 2013 £m
Amounts owed by equity accounted investments	**94**	56
Amounts owed to equity accounted investments	**552**	563

10. Annual General Meeting

The Annual General Meeting of BAE Systems plc will be held on 7 May 2015.

Cautionary statement:

All statements other than statements of historical fact included in this document, including, without limitation, those regarding the financial condition, results, operations and businesses of BAE Systems and its strategy, plans and objectives and the markets and economies in which it operates, are forward-looking statements. Such forward-looking statements which reflect management's assumptions made on the basis of information available to it at this time, involve known and unknown risks, uncertainties and other important factors which could cause the actual results, performance or achievements of BAE Systems or the markets and economies in which BAE Systems operates to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. BAE Systems plc and its directors accept no liability to third parties in respect of this report save as would arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with section 90A of the Financial Services and Markets Act 2000. It should be noted that section 90A contains limits on the liability of the directors of BAE Systems plc so that their liability is solely to BAE Systems plc.